BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2001-164-W/S - ORDER NO. 2002-517

JULY 11, 2002

IN RE:	Application of Kiawah Island Utility, Inc. for Approval of an Increase in its Rates and Charges for Water and Sewer Service.	)))	ORDER DENYING REHEARING AND RECONSIDERATION

This matter comes before the Public Service Commission of South Carolina (the Commission) on Petitions for Rehearing and/or Reconsideration of Order No. 2002-285, filed by Kiawah Island Utility, Inc. (the utility) and by Kiawah Property Owners Group (KPOG), the Town of Kiawah Island (the Town), Cougar Point Golf Company, LLC, Kiawah Island Inn Company, LLC, Kiawah Real Estate Company, LLC, Kiawah Tennis Club, LLC, Night Heron Park Company, LLC, Osprey Point Golf Company, LLC, The Ocean Course Golf Club, LLC, and Turtle Point Golf Company, LLC (KIR)(all but Kiawah Island Utility, Inc. collectively known as the Intervenors). Because of the reasoning stated below, both the Petitions are denied and dismissed.

First, Kiawah Island Utility, Inc. requests that this Commission reconsider certain accounting adjustments adopted by it in Order No. 2002-285, namely, management fees, the Ocean Course Drive Extension, and reduction of plant for availability fees. We reject reconsideration.

With regard to management fees, as the utility noted, the Commission adopted the Staff's suggested adjustment reduction of the recognized expense for management fees

from $100,000 per annum (the actual amount paid) through a reduction of ($64,000). As noted by the utility, the net effect of this adjustment is to reduce its recognized expense for management fees to Kiawah Island Resort Associates, LP (KRA) to $36,000. The utility states that the substantial evidence supports recognition of the entire expense of $100,000. The utility notes that its witnesses Dennis, Clarkson, and Guastella demonstrated that KRA provides services and benefits to it not covered in the direct labor cost and overhead expenses, the specific basis for the Staff adjustment, and asks us to reconsider our holding that "there is an absence of data and information from which the reasonableness and propriety of these services rendered and the reasonableness cost of services can be ascertained." (Order, page 13).

We deny reconsideration on this point. Although there may be some intangible benefits available to the utility by its association with KRA, these are very difficult to quantify, and as such, do not meet the "known and measurable" test for ratemaking. As stated in Order No. 2002-285, the Staff has difficulty gauging participation of the partners and/or directors of KRA in the affairs of the utility. Further, other services and benefits are not quantified. We believe that the direct labor cost of $35,489 and $511 of overhead expense is known and measurable, therefore, we hold that our original adjustment is correct. See Tr., Scott, at 285-287.

Second, the utility requests that we reconsider our finding adopting Staff's proposed adjustment related to the Ocean Course Drive Extension. Staff's adjustment reduced plant by ($210,574) and depreciation expense by ($4,683). The utility notes that Staff based its estimate on the maximum number of 410 taps. The utility states that the

clear weight of the evidence demonstrated that there were far fewer potential taps off the Ocean Course Drive Extension than Staff estimated, and that the entire line is substantially in service. Company witness Guastella stated that the extension can accommodate up to 203 lots, or 285 equivalent residential connections. There are now 186 equivalent residential connections to the main. If the connected equivalent residential connections are adjusted by the Staff's 75% factor, the resulting number indicates that the Ocean Course Drive Extension is substantially in service and the entire line should be considered used and useful, as per Guastella. Tr., Guastella, at 112.

The Company argues that there is no rule or standard that requires that every possible tap be connected to a line before its full cost may be recognized as plant and depreciated. Under the Company's theory, there should be no reduction in plant or depreciation expense resulting from unused capacity. We discern no error in our original holding.

Order No. 2002-285 outlined Staff's very specific methodology in calculating its adjustments on this issue. See Tr., Scott, at 289-291. After reexamination of this testimony, we reject the Company's position that the entire line should be considered used and useful, because, quite simply, it is not. Staff determined that there are in current existence 106 taps out of a possible 410 taps. Clearly, the line is only partially in use, and, as such, we rightfully did not recognize full cost in Order No. 2002-285. We still believe that the formula outlined in that Order properly allows a partial cost of this line to the Company. We reject this ground for reconsideration.

Third, the Company takes issue with the Commission-adopted Staff reduction of plant for availability fees. In Order No. 2002-285, we adopted Staff's proposed adjustment of ($1,512,920) to rate base and ($33,284) from depreciation expense for availability fees collected through December 31, 1991. Staff considers these availability fees to be a contribution in aid of construction, which are related to transferred plant on the books of the utility. Tr., Scott, at 284-285. The Company states in its Petition that these adjustments should not be made to rate base and depreciation expense because KRA has contributed distribution lines and other plant of a value greatly in excess of $1,512,920.The difficulty is that the utility does not carry the contributed distribution lines and other facilities on its books, so these amounts are not officially documented, and the Commission Staff has no way of auditing these amounts. Accordingly, we cannot balance out availability fees with these undocumented contributions. The Company's third ground for reconsideration must be rejected. Accordingly, we deny and dismiss the utility's Petition.

The Intervenors allege eleven (11) separate grounds for rehearing and reconsideration of Order No. 2002-285.

First, the Intervenors repeat their concerns that most of the issues contested by them involve transactions between the utility and KRA that are not at "arms-length." The Intervenors state that, since the management of the two entities is the same, there is no independent protection of rate payers' interests when inter-company transactions between the two companies are involved. Under the Intervenors' theory, when KRA charges costs and expenses to the utility, KRA's profits and cash position increase. If such charges are

allowed for ratemaking purposes, the ratepayers pay for them, and the interest expense on any debt incurred by the utility in order to pay KRA. Also, according to the Intervenors, if the charges are disallowed for ratemaking purposes, and KRA is not required to repay the utility, then the ratepayers still pay for interest expense on the debt, but the cash ends up with KRA. Unfortunately for the Intervenors, however, the evidence used in the record to support this theory is not, in the opinion of this Commission, credible, while the Company's reply testimony on the issue is very credible.

Specifically, Intervenor witness Hissom simply states that the utility and KRA have a relationship that appears to result in "related party transactions," and that the relationship between the two is unusual. Hissom cites as an example the fact that there are Directors of KRA who also serve as officers of the utility. Further, Hissom notes that plant assets of KRA have been sold to the utility at costs that reflect historical installed cost or current replacement cost, which Hissom states is unusual. Tr., Hissom, at 222. We would note that Hissom does not provide specific examples of the latter phenomenon.

As Company witness Guastella correctly points out, Hissom failed to support his beliefs with any quantitative analysis or theory. Further, the relationship between KRA and the utility is typical in Guastella's vast experience. As newly formed developer related utilities with no financial history, the affiliated developers not only typically, but invariably provide funds as an investment in the utility. Tr., Guastella, at 123-124.

We have scrutinized the relationship between the developer and the utility pursuant to the Supreme Court's charge in Hilton Head Plantation Utilities, Inc. v. The Public Service Commission of South Carolina, __S.C.__, 441 S.E. 2d 321(1994). Under

the directives of that case, charges arising out of intercompany relationships between affiliated companies should be scrutinized with care, and if there is an absence of data and information from which the reasonableness and propriety of the services rendered and the reasonable cost of rendering such services can be ascertained by the Commission, allowance is properly refused.

One example of this Commission's utilization of this standard is found in our holding on management fees above. The Company asked for $100,000 in management fees. Staff could only document $36,000 worth of management fees, and we agreed with Staff's adjustment, finding proof for $100,000 lacking. This is but one example of our application of the Hilton Head Plantation Utilities standard as set out by the Supreme Court. The Intervenors have propounded an interesting theory as to how the parent corporation somehow gains from the utility, but we do not find any evidence in the record to support this theory. We have applied the proper standard in the examination of affiliate transactions under the Supreme Court's mandate. Thus, this allegation of error must be rejected.

Further, with regard to management fees, the Intervenors state that this Commission has failed to require KRA to repay "excessive" management fees charged the utility, plus interest. First, this Commission has no statutory authority to order KRA (the developer) to do anything. We only have authority over utilities. This Commission's jurisdiction is defined by statute and does not extend to non-parties that are not public utilities. See S.C. Code Ann. Section 58-3-140 (Supp. 2001) and 58-5-240 (Supp. 2001). Indeed, KPOG recognized this limitation of the Commission's jurisdiction in its

Amended Petition for Rehearing and Reconsideration of Order No. 2000-713 in Docket No. 96-168-W/S, where it stated, "KRA is not under the Commission's jurisdiction..." This was tantamount to a stipulation in that Docket, and we certainly believe that it applies to this Docket as well. See S.C. Dept. of Transportation v. Richardson, 335 S.C. 278, 516 S.E. 2d 3 (Ct. App. 1999), which held that a stipulation has been defined by the South Carolina Supreme Court as an agreement, admission or concession made in judicial proceedings by the parties thereto or their attorneys..and also noting that "Stipulations, of course, are binding upon those who make them..." quoting Porter v. South Carolina Public Service Commission, 333 S.C. 12, 507 S.E. 2d 328 (1998). Clearly, at least KPOG of the Intervenors has already stipulated that KRA is not under the Commission's jurisdiction, and therefore, that the Commission may not order KRA to repay any monies.

Even looking beyond the jurisdictional question, as has been previously discussed, we stated a proper basis in our first Order for granting $36,000 in management fees, and supra in this Order. These were directly attributable to figures appearing on the Company's books. See Tr., Scott, at 285-287. Accordingly, this allegation of error is without merit.

Third, the Intervenors allege that our original Order's provisions regarding purchased water do not comport with the authority granted the Commission by the Legislature in respect of the approved growth factor and the approval of "passthrough" water rates. The Intervenors state that the Order violates S.C. Code Ann. Section 58-5-

240, since no public notification or public hearing is allowed on the reasonableness of future rate increases resulting from the approval of the "passthrough."

An extensive discussion of this Commission's holding on customer growth appears in Order No. 2002-285 at 22. That Order contains the specific formula for calculation of that factor, based on Hearing Exhibit 5, Exhibit A-2. We believe we correctly concluded that Staff's customer growth adjustment covers growth for the increased amount of purchased water, since the factor is also used to compute growth for revenue and expenses by developing a factor from the number of customers on the system.

We would note that the passthrough indicated is strictly the passthrough of any increases in the Company's water costs from its wholesale water supplier, St. Johns. In the past, the lack of a passthrough would mean that the Company would have to return to this Commission for rate relief on a fairly frequent basis. The passthrough mechanism allows adjustment of the rate to the customers, with Commission oversight. We have required the Company to submit a proposed increase in wholesale water costs for study at least 60 days in advance of the time to originate the new charge. The Commission would have the ability to analyze the increase prior to it going into effect, and could reject it if any irregularities are found. See Order No. 2002-285 at 14-15.

Further, we disagree and reject the notion that we are in violation of S.C. Code Ann. Section 58-5-240 for not mandating public notification or hearing on the passthrough of these wholesale water costs. Clearly, the Company's customers will be notified prior to institution of any passthrough increase. Second, however, S.C. Code

Ann. Section 58-5-240 (G) (Supp. 2001) states that the Commission may allow rates to be put into effect without a hearing upon Order of the Commission when such rates do not require a determination of the entire rate structure and overall rate of return. We hold that this is the situation with the passthrough of wholesale water costs from St. Johns, i.e. there is no requirement for a determination of the entire rate structure and overall rate of return. There is merely a passthrough of the increase in the wholesale water cost. Therefore, this allegation of the Intervenors is without merit.

Next, the Intervenors complain that this Commission's granted operating margin in the context of this rate application is "unconscionable, excessive, and constitutes rate shock." As a partial basis for this allegation, the Intervenors compare revenues granted in the present case with revenues granted in past Kiawah rate cases. For example, the Intervenors note that this Commission has awarded the Company $622,000 in revenues in the present case, and state that this is approximately $240,000 more than the highest amount ever requested by the company and fully twice the amount granted in any of the previous rate cases in the past decade. See Petition for Rehearing and Reconsideration at 5. The Intervenors also note, however, that the revenues awarded in this case constitute only 60% of the Company's requested increase. Id. at 6.

Although the burden of proof of reasonableness of all costs incurred which enter into rate increase request rests with the utility, a utility's expenses are presumed to be reasonable and incurred in good faith. The presumption that a utility's expenses which enter into a rate increase request are reasonable and incurred in good faith does not shift burden of persuasion but shifts the burden of production onto the Public Service

Commission or other contesting parties to demonstrate tenable basis for raising the specter of imprudence. Further, the declaration of an existing practice may not be substituted for an evaluation of the evidence. See Hamm v. South Carolina Public Service Commission and South Carolina Electric and Gas Company, 309 S.C. 282, 422 S.E. 2d 110 (1992).

We would note that our Order 2002-285 presents specific discussions covering each revenue and expense item, along with detailed descriptions of our reasoning for each finding. As we held in that Order, we did not find the testimony of the Intervenor witnesses to be credible in attacking the Company's various adjustments. The Intervenors simply failed to demonstrate imprudence on the part of the Company. Clearly, rather than examining how we had ruled on various revenue and expense issues in the past, we specifically and completely examined every issue and laid out detailed explanations for our findings in the present case, which we still consider to be unrefuted.

Further, on the specific issue of the 10.75% operating margin, we would note that the testimony of Company witness Guastella supports our finding in the present case, as pointed out in Order No. 2002-285 at 30. See Tr., Guastella at 108-111. Guastella testified that the operating margin must generate enough income to provide equity investors with a reasonable return on existing investment and to enable the utility to attract capital. The witness then went on to explain the basis for his recommendation. The 10.75% number is actually a combination of separate margins of 9.41% calculated for water and 13.88% calculated for sewer. Tr., Guastella, at 110. See also Application Schedules W-D and S-D. Further, the number recommended was in the range of

reasonableness for water and sewer utilities. Tr., Guastella, at 109. We believe that our finding on operating margin was supported by substantial evidence.

The Intervenors also contest our holding on Golf Course Standby Fees, and state that our approval of this new rate schedule forces the golf courses that have their own sources of water to pay the Company hundreds of thousands of dollars a year for a service that they will rarely use. The Intervenors state that this is a punitive tariff for golf courses that do not need water from the Company. The Intervenors also allege, inter alia, that the newly approved schedule disrupts economic planning and investment and must be reconsidered.

We disagree. The rationale for approval of the rate was explained at length in Order 2002-285 at 33-34. We believe that Company witness Guastella correctly testified that without the Standby Rate in effect to recover the full cost of meeting occasionally large water demands, the existing customers, would, in effect, be subsidizing the cost of the facilities necessary to meet that demand. Tr., Guastella, at 116-117. The rationale provided by that witness is clearly correct, and this portion of the Intervenors reconsideration/rehearing request must be denied.

With regard to issues six (6) through (9) of the Intervenor's Petition for Rehearing and Reconsideration of Order No. 2002-285, we must express some degree of confusion. The Intervenors have referred repeatedly in discussions of those issues to Order No. 2000-713. We would note that this Order appears in Docket No. 96-168-W/S, a prior Kiawah rate case docket, which is a matter presently on appeal in the courts. The Intervenors filed Petition for Reconsideration and Rehearing of Order No. 2002-285 in

the present Docket. There appears to be some confusion on the part of the Intervenors as well as on the part of this Commission as to the Intervenor's intent. We would note that all of the allegations in the Intervenors' discussion of issues six (6) through nine (9) should be denied summarily, since the Intervenors have not outlined alleged errors in Order No. 2002-285, but have pointed to alleged errors in a Commission Order presently already on appeal before the Courts. We would further note that none of these adjustments were raised by the Company in this case, but some were only mentioned tangentially by Town witness Hissom.

However, since the same issues seem to come up repeatedly from the same intervenors in every rate case filed by Kiawah Island Utility, Inc., we will go ahead and rule on the individual issues as if they had been referred to as erroneous in the present Docket.

The Intervenors again complain that we have failed to address the effect of Developer to Utility land leases on the Utility. Town witness Hissom stated that the Company has built utility infrastructure on leased land sites, but that, typically, utilities own the land on which they build immovable infrastructure. Hissom also complains that the Company can later buy the land in question for one-half market value at any time during the lease period. Hissom states that this is one of the "questionable" transactions between the Company and the holding company that owns the utility. Tr., Hissom, at 223. First, we again note that Company witness Guastella found the utility-holding company relationship not-at-all unusual. Tr., Guastella, at 123. We previously examined this relationship under the Hilton Head Plantation Utilities standard, and have found it to

be appropriate. In addition, we would note that the issue of an adjustment for land leases was not raised in this case except for its mere mention by Hissom. We would note that this matter is being litigated in at least one other case before the Courts, and the argument made here has been soundly rejected by the June 3, 2002 Order of the Honorable Casey Manning at 11-13. We also reject the argument on the same grounds as did Judge Manning. As Judge Manning noted, inter alia, neither Commission Regulation 103-541, nor 103-743 requires the Commission to disallow expenses associated with such contracts for ratemaking purposes if the Commission makes specific findings supporting the usefulness of the agreements as well as the reasonableness and fairness of charges arising therefrom, which the Commission has done in various rate cases in the past. Although we think that the land lease issue is being raised improperly in the Intervenors Petition as it was not a contested issue in the rate case below, we reject the Intervenors' assertions based on the reasoning as stated above.

Next, the Intervenors state that this Commission has failed to properly address the issue of $891,660 of "unidentified assets," which were charged to the Company in 1991 by the Developer. Although mentioned in the testimony of witness Hissom (Tr., Hissom, at 223), this matter has been settled by prior rate orders in Kiawah cases, and is further addressed in the Judge Manning's Order at 13-15. As that Order states, this Commission first addressed this issue in Order No. 92-1030, wherein we disallowed depreciation, accumulated depreciation, and interest expense associated with $891,660 of these assets, because it was unclear "whether or not they had been previously donated to the utility company by the predecessor parent." Similar treatment was allowed in Order No. 2000-

713 at 21-25. As Judge Manning states in his Order, and as the Intervenors state in their Petition in the present case, the Intervenors believe that the Developer should repay the Company for the $891,660, plus interest.

As Judge Manning notes, and as we have already noted supra, the Commission does not have jurisdiction in this rate case to order the developer, KRA, a non-party, to repay the Company. Manning Order at 14. As we said in Order No. 2000-927 at 6, if the Intervenors believe that they have a justifiable claim against KRA for various monies, they will have to pursue that claim in another forum. This portion of the Intervenors Petition is also denied.

Further, the Intervenors state in their Petition that this Commission "again failed to properly account for the collection of building incentive fees collected after December 31, 1991." Once again, we would note that the Commission cites an Order from a prior docket when it quotes language, ie. Order No. 2000-713. See Petition at 14. Again, this is grounds for denial of the proposition in itself. In fact, Judge Manning ruled that this Commission had properly disposed of the building incentive fee issue in Order No. 2000-713. Manning Order at 15. Judge Manning also ruled that the Commission properly ruled on the issue in Order No. 2000-927. We hereby incorporate our language in those orders and Judge Manning's June 3, 2002 Order in once again rejecting the allegation with regard to building incentive fees. We have properly ruled on this matter several times in the past, and we readopt that ruling, since no circumstances have changed since we made those rulings.

With regard to fire hydrants, the Intervenors once again cite Order No. 2000-713, an Order from a previous docket, which once again, is grounds for summarily rejecting the proposition. Once again, however, the Intervenors ask that the Developer be ordered to reimburse Kiawah for the cost of fire hydrants, plus interest. Petition at 17. Once again, the Commission has no jurisdiction to order such a reimbursement, as per the Order of Judge Manning, and our prior Orders. Accordingly, reconsideration is denied on this issue.

The next allegation of error on the part of the Intervenors has to do with transmission versus distribution cost allocations. Again, this issue does not appear to have been referenced in the Intervenors' case during the proceeding on this matter. Accordingly, this matter may not now be raised for the first time on reconsideration. We have properly addressed this issue in the past, in any event. See Manning Order at 20.

Lastly, the Intervenors request in their Petition that no action be taken until the outcome of the management audit referred to in Docket No. 98-328-W/S, Order No. 2000-0401 is available, and that the Intervenors request leave to amend and revise their Petition based on the findings of the management audit. This request is denied. There have been major difficulties in preparing for the audit, and much disagreement as to the scope of the audit, the identity of the auditor, and other matters. Therefore, it does not appear to us that we should delay any action on the Petition until said audit is completed, since the completion date of the audit is unpredictable at this point. Nor should we allow an amendment based on the outcome of an audit not yet begun.

Because of the reasoning as stated above, the Petition is denied and dismissed.

This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Chairman

ATTEST:

Executive Director

(SEAL)